Performance Based Procurement

Another Model For California

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Presented At

HARVARD UNIVERSITY

JOHN F. KENNEDY SCHOOL OF GOVERNMENT

STRATEGIC COMPUTING AND TELECOMMUNICATIONS IN THE PUBLIC SECTOR

California Franchise Tax Board

Originally published in February 1995
Revised March 1998

Available on the Internet at: http://www.ftb.ca.gov

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Introduction

The survival of government must be based upon its ability to maintain public trust and to do so in a cost effective manner.

The above statement is a powerful image that should guide policy making decisions in government. Unfortunately, this is not always the case.

In September 1994, the *Task Force on Government Technology Policy and Procurement*[1] addressed the need to redefine how California maintains public trust. The Task Force notes that "For decades, public trust has been based on the principle of checks, balances and controls. When failures occur, the typical response has been to add more layers of control. As layers of control are added, the processes instituted to protect the public trust become so cumbersome as to constrain the ability to effectively manage risk."

The Task Force found that "The policies and procedures instituted to ensure that IT[2] expenditures are appropriate have created an environment in which it takes too long to develop an IT solution from conception to implementation; problems or mistakes are not quickly surfaced; projects are subject to delays and cost overruns; more appropriate technologies are often bypassed in favor of an outdated solution; and an adversarial relationship between the State and its vendors prevails."

The Task Force recommends several action items including: a shortened product delivery cycle, reduction in IT project risks, reform of the procurement process, and the establishment of strategic vendor partnerships.

This booklet discusses one alternative approach to the procurement of technology for government that meets the above recommendations. This alternative approach, approved by the Department of General Services and the Department of Finance as a pilot effort, was developed and used by the California Franchise Tax Board (FTB) for a large, high risk technology project. This document presents the rationale that went into building this alternative procurement model and a conceptual discussion of how the model works. This information is provided to help the reader see the potential value of the new procurement approach, and to allow the reader to determine if the model would be of use for their own organization. Should the reader desire more detailed information, please see the Section "For More Information."

[1] "Task Force on Government Technology Policy and Procurement," a report to Governor Pete Wilson, September 1994, pages I4 - I8.

[2] IT - Information Technology.

The use of this procurement model enabled FTB to cost effectively meet its business mandates. The model, as developed, meets the unique business and cultural needs that exist in FTB. However, while this model worked exceedingly well for FTB, the model, if used elsewhere, must first be tailored to fit the individual organization’s culture, business, and project needs.

Chapter I. What Is This New Procurement Approach?

This new procurement approach is a new way of doing business. It is a paradigm shift in developing and evaluating solutions, in selecting and working with business partners, and in funding new or changing business processes. It is a process of improving risk management of large procurements through risk sharing.

Background

The opportunity to develop and use a new procurement approach originated from a conference held by the California Department of General Services. The conference, attended by government executives and private business, had the goal of developing solutions to fix the burdensome procurement processes. One solution was a two-year pilot during which a new procurement model would be developed and tested. The main requirement was that the model process retain the qualities of competition.

FTB offered to develop and test the new procurement model. FTB, like other government agencies, must meet program and service demands at realistic costs while also complying with the requirements of the procurement system. Balancing the two requirements has became increasingly difficult. The procurement policies and practices that served well in the past are not always practical now, especially for the purchase of goods and services from the dynamic technology market.

The timing for the two-year pilot was perfect for FTB. Having just completed eighteen months of in-depth business and technology strategic planning, FTB management and staff had a shared vision of the future. The strategic planning helped bring a strong business focus to project planning, and revealed a critical need to accelerate the deployment of appropriate technology within FTB. However, FTB did not have the in-house expertise to develop and implement the needed technology on its own. Also, FTB did not have the necessary funding available to meet its technology needs through the normal budget process.

FTB was more than willing to re-think government business processes to help develop another procurement process because the traditional process:

- requires agencies to fully define and document their own detailed technology solutions to business problems prior to soliciting proposals;
- requires agencies to carry all the financial risks of projects;
- results in frequent delays due to vendor protests and hearings;
- results in poor working relationships between government and vendors; and
- results in implementation delays causing the loss of benefits (the technology becomes obsolete, or the business needs changed).

Principles

FTB wanted a procurement approach that would help provide business solutions and improve management for the large, high risk projects needed to meet current and future service demands. FTB wanted a process that would provide:

1. **Strategic Partnerships** - The process establishes partnerships with qualified vendors who have knowledge and expertise in target business and technology arenas. Improved working relationship with vendors can establish long-term, mutually beneficial business relationships based on trust, honest and open communication, and teamwork.

2. **Business-Driven Solutions** - The process focuses on obtaining proven solutions to specific business problems and identifying new and innovative ways of achieving business goals. It is a top-down, iterative process of developing and evaluating ideas in an "ego-less" environment with the goal of achieving business solutions that are "best of breed."

3. **Best Value Evaluation** - The process results in solutions that provide best value to the State rather than only the lowest bid. This is achieved through an objective method that critically reviews and competitively scores solutions based upon the merits of: quality of solution; risk of implementing the new technology and work processes; and net benefit produced.

4. **Performance Based Payments** - The procurement model provides payment to the business partner only if and when the benefits are realized after implementation of the solution. This principle solves the up-front project funding problems, increases vendor commitment to success through their assumption of up-front project costs, and limits the State's financial liability for unworkable solutions.

FTB developed and tested a new approach to procurements that included the above principles. The new approach provided a significant improvement in the ability of FTB executives to make appropriate decisions in managing their business.

Please note: Some of the above individual principles may provide value if applied to the existing procurement approaches. For example: Performance based payments may increase project success rates through sharing of project risks and benefits with the vendor. The model presented here, however, calls for an entirely new procurement approach requiring that all of the above principles be applied together for the greatest value.

Chapter II. Why Use Performance Based Procurement?

Why use a Performance Based Procurement Model? The FTB experience with the model revealed that the new approach can, indeed, provide a better, safer way to do business. This model provided FTB with significant advantages in developing business solution alternatives, in evaluating proposed solutions and the business partners, and in funding new and changing business needs.

Problems Require Change

Any fundamental change in government must be founded on significant opportunity or need. California faces unprecedented problems. The long term fiscal crisis has resulted in the inability of California to adequately "re-invest" back in the basic business functions to maintain or improve the infrastructure. The changing population, increasing service needs, and competition further challenge the ability of California government agencies to succeed. On top of these critical problems, California has also experienced failures in attempting to achieve operational stability and improvement through procurement of cost-beneficial technology solutions. Change is necessary to resolve these problems, and change provides the opportunity for greater benefit.

Change Provides Benefits

The Performance Based Procurement Model provides the following benefits:

- **It reduces the time from project initiation to project implementation and production.** The Performance Based Procurement Model has built-in incentives for bringing solutions to production as soon as possible. The existing procurement process has incentives for delays--delays that may result in a single procurement taking years to complete. Delays also mean business solutions are not available to meet the program mandates, and may mean that by the time the solution is procured it may be obsolete or unsuited to the new business or technology needs.

- **It provides for partnership and teamwork.** The model puts the agency program and technical staff on the same team along with the business vendors. This combined team shares the project management, and shares the project risks and responsibilities. This ensures that decisions and actions will be mutually beneficial. This approach helps to eliminate many of the existing procurement practices that pit agency staff and business vendors against each other.

- **It provides for the "best of breed/best value" solution.** The Performance Based Procurement Model encourages vendors to provide the best solution possible for a business problem. The process to select the winning solution is based upon best value, not just low cost. This give vendors the freedom to prepare their best solution and the agency obtains the most value.
- **It provides project funding from the benefits of the solution.** The model pays the business partner only from the benefits that are realized after implementation of the solution! When, and only when real benefits become available does the vendor receive reimbursement for its costs, up to the contract price.
- **It shares the project risks and benefits.** The model ensures that project risks and benefits are shared fairly between the agency and the qualified business partner. If the project does not provide benefits, then the business partner is not paid. The agency is saved from paying for solutions that do not work.
- **It provides proven technology solutions to meet business problems.** The model is based upon the delivery of a solution to meet a defined business problem. The model encourages the delivery of only solutions that have proven to be effective.
- **It provides for resolution of issues through negotiations.** The model is built around a partnership agreement that requires business partners to negotiate the resolution of issues and reduces or eliminates protests. The reduction in protests mean that projects are delivered earlier and resources are saved. The 1994 Task Force on Government Technology Policy and Procurement found "70 to 80% of IT projects over $1 million are protested." Of these protests, only five per cent are successful.
- **It ensures that mandates such as MBE/WBE/DVBE are met.** The model requires that qualified business partners meet the State's socio-economic mandates. This new process eliminates the acceptance of best effort.
- **It provides needed knowledge and expertise.** The model allows agencies to obtain, from partners, the needed knowledge and expertise to solve business problems. Availability of such expertise may be sorely limited within government agencies, especially experience in new technologies, project management, and business re-engineering.

There are many benefits available if the new Performance Based Procurement Model is used. The remainder of this document is intended to provide enough information on how to use the new model that any government agency will be able to do so successfully.

Chapter III. How To Use Performance Based Procurement

Introduction

COMPARE THE CURRENT MODEL TO THE NEW MODEL

To understand the Performance Based Procurement Model, it is important to see how it compares to the existing business procurement cycle. T he new model completes the same work as the existing process, it has the same level of protection and approvals as the current model, yet it also provides significant improvements:

PERFORMANCE BASED PROCUREMENT	*EXISTING MODEL*
Business Problem - Appropriate for large, high risk technology projects. Focus on describing the problem sufficiently to allow qualified business partners to develop effective solutions.	Focus is on justifying a requirements study. Agency staff independently define detailed business and technology requirements.
Establish Partnerships - Create a pool of qualified business partners who have the expertise and resources to help develop solutions to the defined problem.	*No parallel step.*
Conceptual Business Solutions - Agency staff work with qualified business partners to develop the “best of breed” solutions (solution alternatives).	Agency staff develop solution alternatives.
Final Proposal - Agency staff competitively select the “best value” proposal from the conceptual business solutions.	Agency staff do a cost/benefit analysis (feasibility study) to identify lowest cost alternative.
Contract Negotiations - Agency staff negotiate the terms and conditions of solution delivery with the business partner who developed the “best value” proposal.	*No parallel step.*
Obtain Approvals - Agency staff write Project Plan (FSR) and Funding Plan (BCP) for project approval.	Agency staff write Feasibility Study Report (FSR) and Budget Change Proposal (BCP) for project approval.
Contract Award - Agency staff obtain approval of the unique contract terms and conditions, and sign the contract.	*No parallel step.*
No parallel step.	Agency staff write requirements for project proposal, complete bid process and award standard contract.
Project Development - Same as the existing process except: business partner participates in project management; no payment until solution is in production; business partner has financial incentive to implement a working solution within budget; fewer contract amendments and delays should occur; and the “nice to have” changes may be limited to those that do not affect the project schedule and cost.	Agency staff work with successful vendor to develop and implement solution according to specifications.

In summary, some of the more significant differences are:

- Instead of performing an alternatives analysis based on detailed business and technical specifications, the Performance Based Procurement Model is business driven; i.e., the model obtains qualified business partners to help develop the “best of breed” solutions to solve the defined business problem.

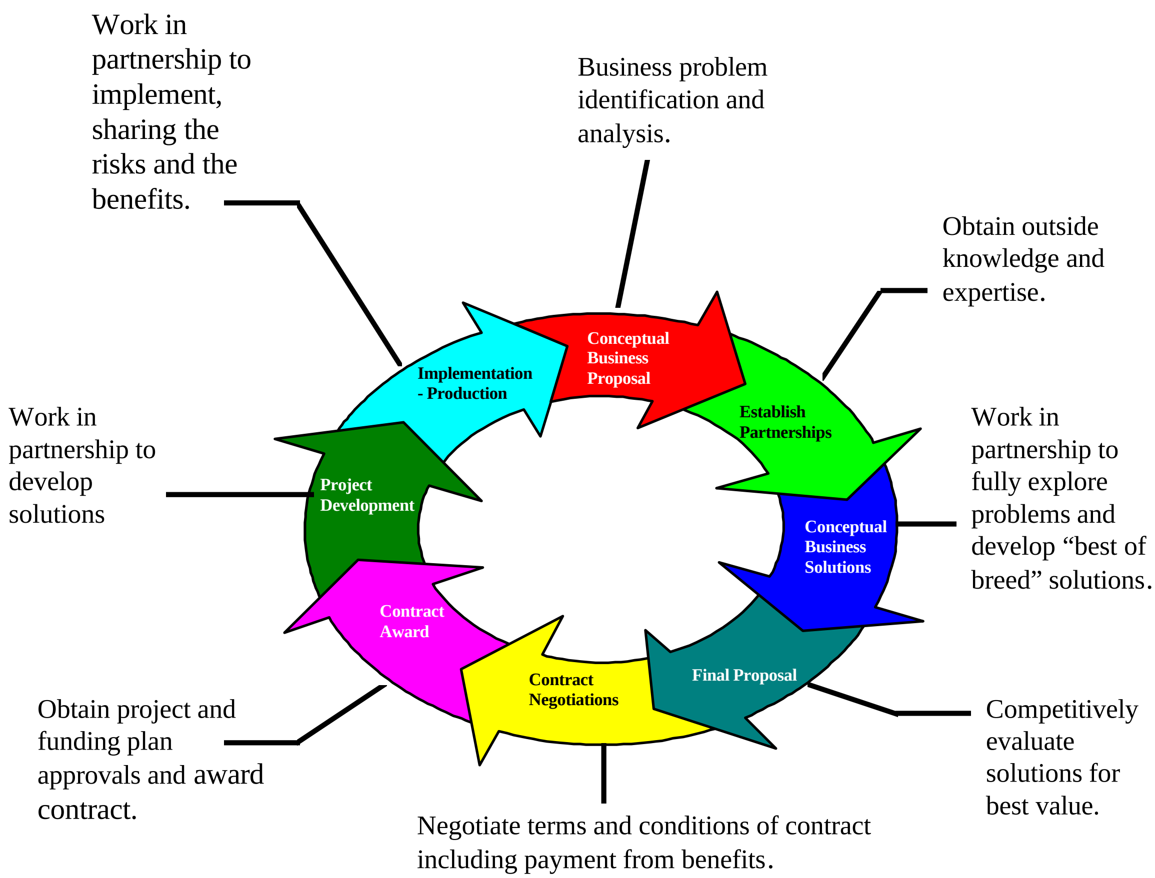
- Instead of performing analysis and documentation of requirements in isolation early in the process, the Performance Based Procurement Model first develops a business case by defining a business problem and a high level conceptual plan for developing solutions. The new model provides for more analysis and documentation of requirements later in the process with the help from outside experts.

- Instead of limiting solutions to those that address the premature requirements, the new model gathers qualified vendors to act as partners in fully investigating the business problem, fully developing the requirements, and in developing the most responsive solution to the business problem.

- Instead of seeking project and funding approval based upon premature requirements and limited solutions, the model seeks project and funding approval after full investigation of the problem and requirements, and selection of the “best value” solution.

- Instead of seeking to procure a solution based on low bid and premature requirements definition, the model has the best solution and is ready for contract award and development!

The following graph represents the Performance Based Procurement Model. The model completes all the work products included in the existing process, however, it provides much more interactive analysis and solution development prior to project and funding approval. In addition, this new model contains unique principles such as sharing project risks and benefits with qualified business partners! The major steps in the new model are :



Franchise Tax Board Procurement Model

THE WORK STEPS WITHIN THE MODEL - HIGH LEVEL OVERVIEW

The Performance Based Procurement Model, just like the existing procurement model, has several steps. Unlike the existing model, these steps can be overlapped as needed to support the agency procedures and culture. See Attachment II for a checklist of the steps. In summary, the steps to prepare for the use of the model and the steps within the model are:

GET READY - Make sure that the Performance Based Procurement Model is appropriate for the business problem and that use of the model is approved:

1. **Identify an Appropriate Business Problem** - Not all business problems and technology projects are amenable to the new procurement model. The model has worked well on a large, high risk technology project.

2. **Obtain Approval** - At this time there are no standard procedures for obtaining approval for the use of the new model. It is important, however, to recognize that this model is a significant change from the old process and as such it is critical that executive management understand and support the use of the model.

GET SET - Set up the foundations for success:

3. **Prepare the Organization** - Successful use of the model requires that the organization have experience in strategic business and technology planning; be able to track and measure the work product at detail levels; be willing to undergo significant cultural changes to work in partnership with vendors; and to accept and implement potentially significant changes.

4. **Define Business Problem** - This standard business step has a new twist: the problem must be defined sufficiently so that qualified business partners can understand enough about it and the existing environment to develop effective solutions.

5. **Establish Partnerships** - In this step, interested business vendors work with the agency to establish their credentials. The agency competitively reviews the vendor credentials and selects a limited pool of the qualified vendors. These vendors become qualified business partners for the agency.

GO!!! - Put the model into action:

6. **Conceptual Business Solutions** - This is the most work intensive step in the process. The agency program and technology staff work in an honest and open manner with each of the business partners to fully investigate the existing environment and business problem, and to develop the "best of breed" solutions. Agency staff must be able and willing to work at a strong pace in order to keep up with more than one qualified business partner.

7. **Final Proposal** - This is the process to competitively select the "best value" proposal from all the conceptual solutions proposed. No longer are solutions selected based solely on low cost. In this model solutions are selected based upon the quality of the solution and the net benefits available.

8. **Contract Negotiations** - This step in the model calls for development of a contract that does not rely on the standard contract models. This contract is significantly different because: 1) Acceptance occurs only when the solution is successful; 2) Payments are provided when and if the solution delivers sufficient benefits to cover the cost; and 3) The contract is for delivery of a working solution. This should eliminate the need for contract amendments to cover cost overruns and other changes needed to make the solution work correctly.

9. **Contract Award** - This step is essentially the same as the existing procurement process with some new twists. For example, it is at this time that the desired solution and real costs are known, so approvals should be obtained now for the project plan (Feasibility Study Report or Special Project Report) and funding plan (Budget Change Proposal). In the existing process these approvals would have been obtained much earlier and would have been based upon premature estimates, and would require new approvals of revised project and funding plans.

10. **Project Development** - This is the same as the existing process, but it is affected significantly due to the changes in the procurement model. For example, there will be a greater feeling of urgency by the business partner to implement the solution because the payments will not occur until after the solution is implemented and providing benefits. In addition, change control must be sufficiently flexible to ensure that needed changes are made, while it must be restrictive enough to ensure that the project cost and schedule are not negatively affected by changes that are only "nice to have." In addition, agency staff must be able to work at a fast pace, understand the sense of urgency and be able to work side by side with others in a team environment.

TIME LINES

It is always helpful to have an idea of the amount of time that may be expended in a business project before committing to the effort. Time estimates can be expressed in terms of elapsed time and in terms of person years (or hours, weeks, months, etc.). Time estimates will vary widely based upon many conditions such as prior experience, availability of staff, availability of expertise, complexity of project, change control, etc. Since time estimates are dependent upon so many factors it is difficult to provide an overview of reasonable time estimates. Regardless, it may be of value to see the elapsed time for the new steps from approval of the Conceptual Business Proposal to completion of the Contract Award that occurred during the pilot use of the Performance Based Procurement Model at the FTB.

CONCEPTUAL BUSINESS PROPOSAL	
Approval to proceed	July 26, 1993
ESTABLISH PARTNERSHIPS	
Letters of Invitation to participate	July 28, 1993
Invitation published in State Contract Register	July 30, 1993
Finish selecting qualified firms	Sept. 15, 1993
CONCEPTUAL BUSINESS SOLUTIONS	
Start sending Solicitation for Conceptual Proposals to partners	Sept. 13, 1993
Receive Intent of Partners	Sept. 16, 1993
Partnership Conference Held	Sept. 17, 1993
Individual Conferences	Sept. 27 to Oct. 8, 1993
Draft Proposals due	Oct. 12, 1993
Draft Proposal discussions	Oct. 8 to Nov. 5, 1993
FINAL PROPOSAL	
Final Proposal due	Nov. 8, 1993
Evaluation	Nov. 8 to Dec. 15, 1993
Intent to award	Dec. 16, 1993
CONTRACT NEGOTIATIONS	
Negotiation	Dec. 17 to Apr. 26, 1994
CONTRACT AWARD	
Award	Apr. 29, 1994

Please note: The above time frames reflect a nine month process. This time included delays in obtaining control agency approvals. In addition, much of the time spent in the above activities is made up for in time saved in the remaining project activities.

Step By Step Process

1. Identify An Appropriate Business Problem

The Performance Based Procurement Model will not work effectively on all procurements. It may introduce new problems and costs if applied to the wrong business problem. Projects that would be considered as most appropriate for the use of the Performance Based Procurement Model include:

- Large Projects. For example a project requiring large investment of resources and staff, with an equal opportunity to gain large benefits.
- New Technology Projects. For example a project requiring new technology where the agency does not have in-house staff with the needed skill or expertise.
- High Risk Projects. A project that contains enough cost, new technology or impact on the business that the agency should look outward for solutions and expertise.

Projects that should **NOT** be considered as appropriate for the use of the Performance Based Procurement Model include:

- Projects that have specific, easily defined deliverables, such as hardware replacement.
- Projects where the agency business managers can not/will not be involved.
- Projects that affect business areas that have no performance measurements.

"THE FTB EXPERIENCE"

FTB needed to replace the Bank and Corporation (B&C) system, a large scale integrated business process which included a 20 year old automated system. This business system is one of the most critical operations of the FTB. The inability to establish a funded project for this replacement led FTB to assume the task of developing and implementing the Performance Based Procurement Model. FTB hoped that such a procurement model would result in an effective, viable project for replacement of the B&C system.

FTB consciously chose to deal with the B&C system as three separate, but integrated, components: 1) Accounting; 2) Collections; and 3) Audits. These different components required different business and technology knowledge and experience. As a result, FTB used the new procurement model in three distinct procurement phases with three different Project Steering Committees and Project Teams. This experience resulted in the selection of solutions from multiple business partners and maintained the requirement of competitiveness.

The business and technical staff at FTB felt that the final selected solutions were better than could have been expected in any other procurement process.

Questions and challenges which remain for FTB and its contracted business partners are: Can multiple vendors work together to integrate systems? Since the anticipated benefits of the three system components are somewhat inter-dependent, how well will the business partners work together to achieve the full benefit stream? What will happen if one partner fails to deliver the solution on time with the needed functionality? To date, these questions and challenges are open but the current experience indicates that the working environment will enable all parties to work cooperatively together and to succeed.

2. Obtaining Agreements

The FTB use of the Performance Based Procurement Model was a pilot process which required that agreements be established throughout the effort. Here we cover the experience relative to the FTB effort. Agreements or approvals for other formal Performance Based Procurements may differ from the FTB experience.

In order to participate in an alternative procurement pilot [3], the FTB had to obtain agreement from both internal management and external control agencies. This was difficult because there was no prior experience upon which to establish the likelihood of success or to determine the amount of risk exposure that would exist.

To support the decision to proceed with an alternative procurement process, the FTB did a market survey to establish the existence of vendors who had experience with the size and complexity of a tax system similar to the one that FTB needed to implement. A survey of tax administration agencies in the United States was conducted to determine if the agencies had recently implemented a new tax system with assistance by vendors, as well as to survey the 10 vendors most likely to have the type of experience required by FTB. The survey, completed in April 1993, revealed that nine tax administration agencies had used vendors to implement systems and there were five vendors who had the experience and knowledge needed by FTB.

As a result of the survey, a business case justification was prepared showing the business need, and that transportable systems[4], which could be tailored to solve FTB's business problem, were available. In addition, the survey identified the existence of proven solutions which would significantly reduce FTB's risk when implementing the Bank and Corporation (B&C) project.

Agreement to proceed with the alternative procurement model was obtained from FTB management in June 1993. Agreement to proceed was obtained from Department of Finance and Department of General Services late in July 1993.

[3] The California State Administrative Manual, Section 5215 (revised 9/93) discusses pilot alternative acquisition techniques.

[4] Transportable systems are those systems developed in one environment, which with modification, can be installed effectively in another, different environment.

3. Prepare the Organization

The decision to use the Performance Based Procurement Model must be based upon the likelihood of success. The success requirements for this model are broad, ranging from staff attitudes to the ability to measure program costs in detail. Specifically, before an agency uses the Performance Based Procurement Model the agency must:

- **Have a definable business problem.** An agency must have a definable business problem, and be dissatisfied with the standard approach to solving problems. An agency should be dissatisfied with the *need*[5] to develop technology solutions in-house. The level of dissatisfaction will help support the agencies' willingness to change procedures, and to devote the resources needed for success.

- **Be willing to change the approach to solving problems.** An agency must be open to creative solutions, and must be able to trust that effective solutions can be developed through the interaction of agency staff and outside experts.

- **Be willing to change relationships.** An agency must be willing to shift from independent to dependent working relationships. They must be able to establish strong, equal partnerships between internal program and technology staffs, and qualified outside experts. An agency must be open to outside solutions, and be willing to allow vendors to "sell" solutions to program managers as well as technology managers. An agency must be open to working with outside vendors in exploring business problems, and be receptive in considering changes that impact their business and technology.

- **Be willing and able to commit resources.** An agency must prepare staff for the culture changes that can affect project working relationships, as well as normal business processes. The agency staff must be educated in the new process and accept the new process as a valuable business alternative. An agency must have a high caliber of staff able to work effectively with vendors to protect agency investments and not be misguided by vendors. The program and technical staff must be willing and able to take an active lead role, and make the job commitment necessary for rapid, accurate impact analysis of solutions.

- **Have cohesiveness and shared vision at the management level.** An agency must have completed strategic business and technology planning so that the vision of the future has already been developed and accepted by agency management and staff. The agencies' management structure must be flexible and able to accept something new, and it must also be able to tell vendors when solutions are not congruent with the direction of the agency. An agency must have standards in place to provide guidance and to support decisions.

[5] The term "*need*" refers to the belief that the only viable option is to develop technology systems in-house.

- **Have the ability to keep focused on the business vision.** An agency must have management, program, and technology staff well versed in teamwork. The staff must be able to maintain focus on the goals of the business.

- **Have the ability to use performance measurements.** An agency must be able to develop and use performance measures similar to those used in performance based budgeting. This is essential to determine and measure benefits that result from implementation of business solutions. In addition, an agency must be able to work impartially and honestly with vendors in identifying the benefits likely to occur from solutions, and then be committed to ensuring that those benefits are fully realized.

- **Have an open philosophy toward procurement processes.** An agency must have an open philosophy in regards to new ways of doing procurements. They must be fully apprised of the time investment needed to ensure success and to control risk. An agency must understand that the Performance Based Procurement Model is not written in concrete, and that there is no cookbook solution. An agency must be able to rise to the occasion and be willing to meet and conquer issues as they occur.

If an agency is ready to successfully use the Performance Based Procurement Model, there are several things that must be done to prepare the organization. The most important is to establish the teams that will undertake the work. The use of teams is critical to the Performance Based Procurement Model because of the interaction expected from program and technical staff, and vendor staff. The use of teams to accomplish critical work provides:

1. A broader perspective of the business, the problem and the solutions.

2. More effective use of employee talents, skills, ideas and knowledge.

3. Improved communication by removing intimidating barriers such as employee classification and levels of responsibility.

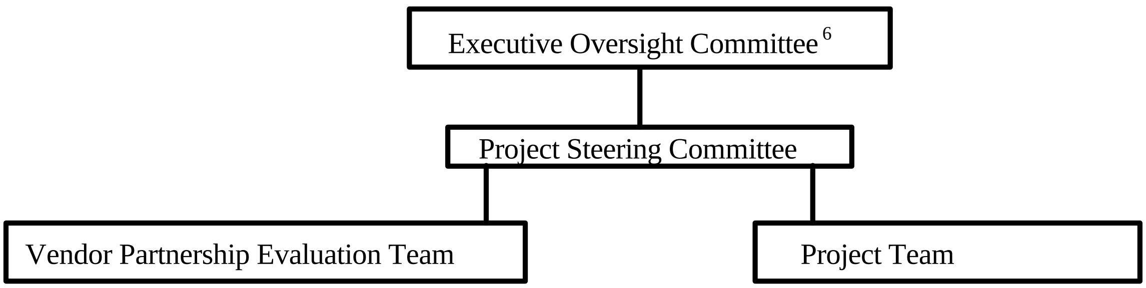
4. Early buy-in on project objectives and solutions.

5. A common understanding that promotes a sense of shared decision making.

6. A sense of empowerment and self-worth.

7. Staff development by way of knowledge transfer.

This new approach to procurements requires multiple teams. However, with multiple teams there might be duplication of efforts, and an increased risk that important issues will not receive the attention needed. To reduce duplication and ensure all issues are covered, clear roles and responsibilities for the various teams should be developed. The model calls for the standard teams expected with any high risk project. In addition, the model calls for a Vendor Partnership Evaluation Team to have responsibility for developing a pool of qualified business partners. Thus, the teams needed for the model are:



Careful consideration of team membership is critical to the success of the process. The assignment calls for the best mix of staff representing a cross section of the agency. The critical nature of the target business program will require people who have the best business knowledge. Because the teams are expected to work as equal partners with vendors, the best team players available should be assigned.

[6] The Executive Sponsor for the project is also a member of the Executive Oversight Committee.

“THE FTB EXPERIENCE”

Preparing the FTB organization for the development of and then the use of a new procurement model involved several steps. The most important one was to establish the teams that would undertake the work. The Franchise Tax Board established an Executive Oversight Committee, a Project Steering Committee, and Project Teams for the B&C project components.

The FTB also established the “Performance Based Procurement” Steering Committee to oversee development of the new procurement process. This Committee included members of the Executive Oversight Committee and the project managers. In addition, FTB added a new team, the Vendor Partnership Evaluation Team, to develop and then implement some of the steps in the new procurement model such as advertising and establishing criteria for vendor evaluation and selection. The final organizational change was to assign a full time manager responsibility for the model development and for successful implementation.

FTB had just completed the departmentwide strategic systems planning effort and the staff involved in that planning effort had experience in visioning, were able to shift paradigms, and work cooperatively with vendors. The staff formed a core of staff able to step in, understand the department needs, and work openly and cooperatively with qualified business partners. The teams were expected to use team driven principles. The mix of team members had to take into account complex needs including the best available staff from program, technical, and administrative areas.

The Project Management Teams, normally comprised of FTB program and technical project lead staff, had to change as a result of the new Procurement Model. With the implementation of the new Model, it was necessary to extend project lead responsibilities to include the qualified business partners. Since the Partners share the project risks and the benefits, they must have some say in managing the project.

4. Conceptual Business Proposal

Define the Problem

The starting point for the Performance Based Procurement Model, as with other approaches to business management, is the existence of a business problem or opportunity. The model calls for development of a "Conceptual Business Proposal", a high level business plan which includes the definition of the business problem, and the plan for developing a solution. The Conceptual Business Proposal can bring to bear new issues and questions that may not exist in other processes.

The main purpose for defining a business problem is to establish the basis and justification for the need to develop a solution. In addition, the business problem definition also establishes guidelines for the approach to solving the problem. These guidelines, at a minimum, include: the problem scope; solution objectives; project/solution limitations; and, existing costs and potential benefits. In order to establish and accurately define the business problem using the Performance Based Procurement Model, an agency must also:

- ♦ Have a long term VISION that allows for appropriate decision making with regard to solution development and selection.
- ♦ Have business goals and objectives which allow for accurate targeting, and measuring of solutions.
- ♦ Have in place the means and the methodology for measuring the cost of the business elements, and the cost of the problem, so that accurate cost/benefit analysis is possible.

Noticeably absent in the Conceptual Business Proposal are detailed business or technical requirements. The model is built around the theory that it is premature to set specific detailed requirements for solutions when knowledge about potential solutions is unavailable. The Proposal is NOT a Feasibility Study Report (FSR) and it does NOT provide an estimated cost/benefit of a possible solution, again because it is premature. The Conceptual Business Proposal is merely "a proposal" which:

1. Justifies the business case (the business problem is real and significant);
2. Provides high level guidelines for what a solution would look like;
3. Establishes high level costs/benefits and risks for continuance of the current process; and
4. Lays out a methodology and time frames for developing and selecting a solution.

The Conceptual Business Proposal provides a recommendation that will impact the business and finances of the agency. As such, the Conceptual Business Proposal must be approved. The approval authority may be internal or may reside with Control Agencies, depending upon the specifics of the recommendation.

Cost/Benefits

One of the issues likely to be raised in regard to Performance Based Procurement is the ability to establish sufficient measurable benefit.

Government agencies using the Performance Based Procurement Model will have to establish benefits sufficient to offset the cost of the solution. Such benefits must be measurable and attainable as a portion of these benefits is expected to be the source of payment to vendors. Benefits come from:

1. **Increased income.** Not as straightforward as one might expect, this benefit stream must be identified as separate and apart from other impacts on income. For example, if the benefit income is based upon improving collections, then the real benefit from the business solution can not include population changes that would have resulted in a normal increase in collections. Likewise, a reduction in income that is not the result of the business solution, must not be allowed to obscure the real benefit income.

2. **Operational savings.** Operational savings are the reduction in baseline costs. This reduction must be tangible and available for payment to the vendor partner. For example, if the solution had the potential to reduce operations costs by 30%, and the actual implementation resulted in a 30% savings, then the appropriate baseline reductions must take place so that “redirection” of funding can occur to allow for payment to vendors.

3. **Cost avoidance.** Cost avoidance is the term used to identify benefits that occur when future program needs are met at less cost than would otherwise have been required. Fundamental in establishing “cost avoidance” is the recognition by the Department of Finance that the program needs would have been funded. Such program needs can include new program services, increased program service levels, or replacement of current systems. The recognition by the Department of Finance provides a commitment that payments will be funded. Under the new Performance Based Procurement model, this commitment for payment would be based upon successful implementation of the solution, and achievement of the level and quality of services agreed to.

"THE FTB EXPERIENCE"

For FTB the business problem was fairly well established in the prior attempts to obtain project approval and funding. FTB found there to be a fundamental difference between defining a problem to obtain funding, and defining a problem so that outside partners can develop effective solutions! Thus FTB had to have a new approach for defining the business problem.

The FTB program executives found tremendous value in this new approach. It was a process of self searching, and of questioning the old business assumptions and processes. This penetrating evaluation provided the opportunity for identifying and implementing business improvements not related to the project, and it provided a powerful validation of the appropriateness of existing policy and practices. This kind of intense research requires that the best staff be assigned throughout the project to ensure business problems are appropriately addressed and to obtain full benefit from the findings.

The Departments of Finance, Office of Information Technology[7] (DOF/OIT) and the Department of General Services/Office of Procurement (DGS/OP) were invited to participate in the new process. DOF/OIT declined, while DGS/OP assigned an analyst to participate in the early development phases. In addition, several briefings were held with the Department of Finance Budgets and OIT, and with DGS/OP to provide information on the process.

The business problem definition information was used to develop the Conceptual Business Proposal, and to obtain approval to proceed from the FTB Executive Oversight Committee and from Control Agencies (DOF Budgets and OIT, & DGS/OP).

FTB found the review and approval process difficult. It was assumed that the difficulty was because the approach and procedures were outside of normal operating procedures, and some staff were still in the old paradigm of procedure and paperwork driven procurements. This led to questions consistent with an FSR, but unanswerable in a Conceptual Business Proposal!

[7] Effective January 1, 1996, the Department of Finance, Office of Information Technology was replaced by the Department of Information Technology (DOIT).

5. Establish Partnerships

A basic principle of the Performance Based Procurement Model is the formation of "strategic partnerships." Private industry is invited to participate in the process of developing business solutions for an existing business problem. The intent is to have a public selection process that provides a pool of vendor partners who have the resources, expertise, creativity, and financial ability to provide the best of breed solutions for consideration and implementation. The selected qualified partners sign a formal agreement to:

⇒ Work in trust

⇒ Resolve differences through negotiations

⇒ Meet the State's socio-economic mandates such as: minority, women and disabled veteran business enterprises (MBE, WBE, DVBE).

It is important to recognize that the establishment of strategic partnerships is just the initial step in the development of a long term cooperative relationship. The actual "partner relationship" is developed throughout the process, and does not exist merely as result of a signed agreement. It is the process, not the form, that makes working relationships of value.

The establishment of partnerships is an on-going process. New vendor partners may join at convenient junctures, such as the introduction of a new business problem. One value of the new Performance Based Procurement Model is that it allows potential partners to make early decisions whether or not to participate in the partnership, or on any project initiative. The model has inherent costs which encourages vendors to be selective in where and how they want to do business. The existing procurement process allows and encourages vendors to bid on a multitude of projects with minimal investment and understanding of the business problem or agency needs. This results in a larger number of bids to a State procurement, and a lower overall quality of the solutions.

The new Performance Based Procurement Model requires, on the other hand, a larger up front investment and commitment. The up front effort helps to improve the quality of bid solutions provided to the State. The degree of up front commitment requires:

- The partners to have the resources, knowledge, and experience to participate.
- The partners to be willing and able to invest resources in in-depth research about the business problem.
- The partners to invest resources in the development and implementation of the solution.

All of this is done with the understanding that reimbursement for the project costs will depend upon the success of the solution in generating sufficient benefits. If the solution does not generate benefits, then there is no payment to the partner!

To establish a partnership pool, the following steps should be followed:

1. **Advertise for partners.** The intent is to find business vendors interested in participating in this new procurement model. To obtain the largest possible pool of vendors, it is recommended that vendors be sought through advertising as well as a direct mailing effort.

2. **Provide a Conceptual Business Proposal and Business Partner Selection package.** Interested vendors should contact the agency to obtain a copy of the Conceptual Business Proposal and Business Partner Selection package prepared by the agency. The Business Partner Selection package outlines the purpose of the procurement process, the screening criteria, and the expected structure of the vendor's "intent to participate" response.

   Interested vendors will prepare and forward their response. The response, or "intent to participate" should include, at a minimum: Internal organization and size, qualification of vendors and the proposed team, customer references and an engagement reference list, financial responsibility and reports, agreement to adhere to the Quality Partnering Agreement, and agreement to adhere to and meet the participation goals for minority, women and disabled veteran business enterprises. (Best effort is not acceptable for meeting the participation goals.)

3. **Evaluate potential partners**. Using the information contained in the "intent to participate" documents, the Vendor Partnership Evaluation Team performs the evaluations. These evaluations should be done using pre-developed, and validated, measuring tools. The evaluation has two steps:

   > **The first step** is to ensure that the mandatory requirements were met. If the vendor response does not include the mandatory information, the rating of that vendor is suspended, and the vendor notified of the findings. Vendors are allowed to submit additional supporting information or clarification where deficiencies are noted.

> **The second step** is to evaluate the specific quantitative information that the vendors provide. This quantitative information includes:

⇒ **Financial status** - does the company have the financial backing to partner in the project without payment until the anticipated benefits have been obtained?

⇒ **Stability** - has the company shown the ability to remain in business over time?

⇒ **Prior experience** - has the company worked on projects similar in scope and size? Contact the prior clients and obtain qualitative responses to patterned questions.

⇒ **Expertise** - does the company currently have available the level of expertise needed to develop and implement the targeted systems? Use of Data Base methodologies? Large systems?

⇒ **Ability to work with government agencies**, specifically California?

⇒ **Project Management** expertise?

⇒ **Customer references**?

The results of the evaluation are discussed in private with each participating vendor, and each vendor is provided ample opportunity to fully qualify for partnership. If a vendor is unable to establish that they qualify, they should be encouraged to contact a qualifying partner and to offer their skill and knowledge as a sub-contractor if they feel they can add value to the project. When the evaluation team determines that a vendor is "qualified", the vendor information and recommendation are forwarded to the Project Steering Committee for their consideration.

The Project Steering Committee should hold confidential meetings with each of the potential partners to discuss the executive level expectations of the agency, and to hear first hand of the ability and commitment that the vendors are willing to put into the process. In addition the Project Steering Committee should be responsible for:

1. Obtaining approval of the partnership by the vendor's Chief Executive Officer since the partnership can have a tremendous financial impact on the company.

2. Considering the new model partnerships and the potential consequences to vendors who are applying for partnership and who also have existing contracts with the agency. For example, if a current vendor applies, but is not selected as a qualified partner, will there be a change in the working relationship?

Once the Project Steering Committee has made final determination regarding the qualifications for partnership, the qualified vendors are notified in writing. The agency Executive Oversight Committee and the qualified vendors should have a formal meeting for signing the Quality Partnering Agreement (See Attachment I). A pool of qualified business partners is available at this point.

"THE FTB EXPERIENCE"

To establish the partnership pool, the FTB advertised in the California State Contracts Register with the following special notice:

> *"The Franchise Tax Board (FTB) is developing a new approach to procuring services. Contingent upon approval of the California Department of General Services and the Department of Finance, FTB will use the new "alternative procurement process" to replace its existing Bank and Corporation (B&C) Tax System with a modern Business Entities Tax System (BETS).*
>
> *FTB will be establishing partnerships with firms who have demonstrated success in large tax system designs, Data Base Management System environment development, and who have experience in implementing new products and technologies. Establishing cooperative partnerships will give the FTB the opportunity to incorporate the expertise of partners in the BETS design and streamline the procurement process.*
>
> *FTB expects partners to share in the risks of successfully developing and implementing BETS. FTB anticipates that the joint venture benefits will serve as the source for compensating its business partners. Payment will begin once the new system is operational and will be funded from benefits generated from the new systems. FTB anticipates that the initial system will be operational January 1995. With benefits for the BETS anticipated to be in the multi-million dollar range, the rewards will make the risks worthwhile."*

In addition, the FTB did direct mailing to the vendors found in their initial survey and to over 400 vendors listed with the Department of General Services. FTB repeated the partnership process three times during the first year of the pilot.

FTB had 21 vendors respond to the solicitation. Eleven vendors provided the requested information and six vendors were selected as qualified. Two additional partners were added to the partnership pool during subsequent screenings.

6. Conceptual Business Solutions

The purpose of the conceptual business solution phase is to develop the best solutions possible by working in an open and honest environment with each business partner. This is an interactive process designed to increase each Partner's understanding of the agency business requirements and to ensure that agency staff clearly understands each Partner's proposed solution. This process includes evaluation of draft proposals with detailed feedback provided to the business partners.

The very success of the new Performance Based Procurement Model is dependent upon open and on-going communication between involved parties, especially in the Conceptual Business Solutions phase. This communication includes providing access to privileged or critical information while maintaining confidentiality of each other's work product or records.

This communication encourages and enables vendors to develop the best knowledge about the existing agency problem, and allows prompt and accurate feedback on issues. The process aids in improving each business partner's proposal; it is what brings forth the "best of breed" solutions and enables agencies to obtain the best value. This phase is less constrained than normal procurement activities where conversations are severely limited or eliminated altogether to avoid giving advantage to one vendor over another, although staff using the new model must take care to ensure that one business partner is not given favored time or information over the others.

This phase requires a tremendous time and resource commitment for all parties. It is important to note here that this communication can not be done with an overabundance of qualified business partners. It is therefore essential that the process allow for early decisions by Partners whether to participate or not, and allow for competitive selection of a few of the most qualified vendors to move to and through this phase. It is essential that there be a reasonable number of proposals, partnership teams, and evaluations to ensure a truly competitive process, otherwise the cost to agencies may be prohibitive.

The Conceptual Business Solution is completed through a series of events. These events, while shown as separate sequential steps are merely guidelines that reflect recommended milestones. The entire series of events require continuous communication and feedback between the business partners and the agency staff. The events are:

1. Solicitation for Conceptual Proposal (SCP)

The agency develops and distributes the Solicitation for Conceptual Proposal (SCP) to the business partners. The SCP is a formal written document provided to the qualified business partners asking for proposals to design, develop, test and implement a solution to the existing business problem. The SCP contains the following information:

- **Introduction and process overview.** This includes the purpose of the solicitation, an explanation of the procurement process and phases that will be used, the department contacts, and key action dates.

- **Proposal.** This includes an overview of the agency organization, the business programs and responsibilities, the current operational environment, the business problem, solution objectives, business and systems performance criteria, and expectations of business partners.

- **Cost and payments information,** including the need to identify the business partner's basis for charging, the need to compare charges among business partner proposals, and the payment expectations, including the fact that the payment will occur only when and if solution benefits occur, and that the payments must be reasonable and achievable.

- **General administrative information,** including proposal format and content, contract terms and conditions, and issue resolution steps.

2. Partnership Conference

The agency conducts an open presentation of the agency problem for interested qualified business partners. The presentation provides additional detailed information about the existing agency problems, agency environment, and agency expectations. It also provides an opportunity to answer questions from the qualified business partners.

3. Meetings with Interested Business Partners

The agency works in confidence with interested business partners to help them explore the agency problem in more depth. These are individual meetings to allow the business partners to address concerns and ask questions about the SCP. At this time, the business partners will have a better understanding of the problems faced by the agency and can use this information to withdraw from further participation or to reaffirm the feasibility of their continuation on the project.

4. Business Partners Develop a Draft Proposal and Submit It to the Agency

This is an iterative, conversational mode of proposal development. Agency staff and each business partner work together in confidence to investigate further the existing business problem, and to assess and discuss the viability and effectiveness of the business partner's proposed methods of solving the problem.

This event is concluded by the submittal of a draft proposal by the business partners. This phase may be repeated if more that one draft proposal is needed. For example, the first draft may only address the business proposal, such as workflow re-engineering, with a subsequent draft submittal that contains the technical recommendations to correspond to the business recommendations

5. Agency Evaluates Draft Proposal

Agency staff evaluates the submitted proposals on several criteria, including; solution's ability to meet and/or exceed the agency business and technical requirements, reasonableness and ability to achieve the benefits/revenues projected by the business partner, and overall impact including compatibility with architecture standards, ease of use, security and integrity requirements, and etc. During the evaluation period, open and honest discussions continue between the agency staff and the business partners. The agency meets in confidence with individual business partners to provide in-depth feedback on the evaluation of the draft proposal.

It is important that throughout these events care is taken to ensure the confidentiality of the discussions. Confidentiality is important because the agency staff will be privy to "work products" that are the property of the participating business partners, and the business partners may be privy to agency information that is subject to confidentiality laws.

"THE FTB EXPERIENCE"

It was interesting to note that the FTB project teams felt that this specific activity, working in face to face interactions made the working relationship significantly positive, and gave the best sense of a business partner's ability to meet the needs of FTB. This approach provided the fastest response to raising and solving issues, ensured that the business partners did understand the problems, that FTB staff understood the solution, and gave each participant a better feel for the commitment of each other.

In addition, the participants felt that the communication established and used throughout this phase was a vital aspect to the development of effective solutions. The communication provided continual checkpoints to make sure that everyone was on the same track. It also helped establish excellent risk and quality assurance in each business partner's proposal.

This was also the most important step for transfer of knowledge. The FTB program staff shared their knowledge of their business programs and the existing problems to the FTB technical staff and business partners. The FTB technical staff shared their knowledge of existing and planned technical standards and architecture to the business partners and FTB program staff. And the business partners shared their knowledge of new processes and technology, and potential solutions to the FTB program staff and technical staff.

7. Final Proposal

The final proposal phase, just like the Conceptual Business Solution phase, is completed through a series of events. Again these events are depicted here as separate sequential steps to provide project milestones. In reality the sequence of events must be tailored for the unique agency and project addressed. This phase is also marked by continuous communication and feedback between the business partners and agency staff.

A key component in this final proposal phase is the “best value” evaluation of proposals. “Best value” is based on a number of components, from the impact of the solution on the business and technical programs, to the benefits expected. The “best value” approach assumes the agency will adopt a solution in its entirety. This model does **NOT** recommend that agencies attempt to select the best components from each solution, as it is highly unlikely that separate components from separate solutions will effectively work together.

The events in the Final Proposal phase are:

1. **The business partners prepare and submit a final solution proposal.** Once the qualified business partners have developed their best solution, they prepare and submit a final proposal to the agency. The business partners are expected to follow the guidelines set up by the agency for the development and presentation of the final proposal.

2. **The agency staff evaluate each final proposal for “best value.”** Care must be taken to ensure fairness in this evaluation. The solutions are different which makes it difficult to develop a net assessment of benefits for comparison between the solutions. The “Best Value” evaluation for the Performance Based Procurement Model must be based upon a pre-defined evaluation criteria. Such criteria would, at a minimum, include:

Quality

- **Partnership Quality.** Evaluate the business partner’s willingness to engage in open and honest communication with the agency in developing an understanding of the business and technical requirements, and in working together with the agency to develop a proposal addressing those requirements. The criteria for the evaluation should include prior experience with similar systems including actual vs. projected time and costs; satisfaction of previous customers; degree of diligence used in investigating and learning about the agency’s business and problems; and the ability to commit the resources necessary to complete the project.

- **Meeting Business Requirements.** Evaluate the business partner's proposal for meeting the business requirements, i.e. fully automated, partially automated, or manual. Include the extent to which the proposal would meet the customer's needs, the clarity of the proposal, and the functionality proposed.

- **System Management Features.** Evaluate the business partner's proposal for the processes, facilities and displays involved with system management, and reporting or evaluation of the work product. This would include the extent to which the proposal meets customers needs, the clarity of the proposal, and the functionality proposed.

- **User Friendliness.** Evaluate the business partner's approach to the overall system, including the "look and feel" of the recommended solution processes. This includes the degree to which the system is "intuitive", the ease with which the user can change processes, rules, models, work schedules and data presentation, and the help functionality provided.

- **Business and Technical Training Approach.** Evaluate the business partner's approach to training including environment, materials, classes, instructional aids, etc., to allow for an effective and efficient installation and ongoing operation of the new system. In addition, the evaluation should take into account how the system manuals, unit procedures, and training proposed would support the end-user community, the plan for transfer of knowledge, and the use of training tools.

Risk

- **Project Management.** Evaluate the business partner's project management experience, communication plan, issue resolution plan, and change control plan. The evaluation should include how the partner addresses and uses the systems development life cycle, skills offered, quality of the work plan, types of project management tools proposed, and project change control and quality control procedures.

- **Costs.** Evaluate the business partner's understanding of the costs for the project. Is the cost information in the proposal complete, clear, realistic, and consistent with the solution proposed?

- **Data Center Impact/Production Platform.** Evaluate the business partner's proposed impact on the Data Center during development and implementation. Does the proposal maintain security, and the use of productivity platforms such as databases. Does the proposal include the conversion time, backup and recovery procedures? Does the proposal address equipment and/or system software changes, support staffing needs, and allowance for growth. Can the proposed solution simultaneously run batch and on-line processes, etc.?

- **Development/Implementation.** Evaluate the business partner's approach to development, and transition from development to production. Evaluate the Partner's ability to find the best fit between the use of new technology and existing systems, and the partner's plans to modify, or re-engineer work flows and processes to take advantage of new technology. How would the proposed system impact existing systems? Are the post-implementation support plan and interfaces with other business programs acceptable?

- **Ease of Maintenance.** Evaluate the business partner's proposal for ease with which system changes and enhancements can be developed and tested, including modularity, data independence, and documentation. Does the proposal include appropriate upgrade paths with appropriate costs? What are the maintenance plans and costs, and how well can the solution transition into maintenance?

Benefits

- **Benefits.** Evaluate the business partner's ability to bring in the expected benefits within the expected time frames. Does the proposal identify appropriate types of benefits streams, are there duplicate savings, are the anticipated benefits realistic and achievable?

- **Infrastructure Improvements.**[8] Evaluate the business partner's proposal for taking advantage of new technologies, including the degree of value that is added beyond the business requirements. How well will the proposed technical platform support future technology within the agency? Is the foundation consistent with the long term architectural plans? Is the proposal compliant with standards and is the proposed solution portable to other platforms? "Credits" may be provided for proposals that include valued infrastructure improvements such as equipment or software. Valued equipment is defined as equipment that would be procured in the near future, with or without the project. As such, the credit may offset future anticipated procurements.

- **Other.** Evaluation might include a "Royalty" benefit stream. Such royalty would occur if the solution was to be jointly developed, and then marketed to others. The solution cost/benefit may take into account the ability to share potential royalties.

[8] Infrastructure Improvements should only include those improvements needed for implementation of the solution.

For each of the above components a score should be given dependent upon the relative ranking of the proposal. Each component may also be weighted in value. It is recommended that individual reviews, evaluations and scoring should be done first. Then the individual evaluators should meet to establish an overall consensus. While this evaluation may be subjective, it is in practice excellent because it is based upon objective criteria, and requires each evaluation team member to support his/her rating to reach consensus.

It is strongly suggested that the rating methodology and tools be developed in advance, and be tested for validity and reliability. One of the recommended tests is to develop a variety of "test solutions" and use the methodology and tools to rate the solutions. The "test solutions" should include poor solutions as well as excellent solutions. This test can also provide an opportunity for staff to gain training and experience in using the rating methodology and tools.

3. **The business partners provide a formal presentation of the solution.** During the "best value" evaluation, the business partners are invited to provide the Project Steering Committee presentations of the proposed solutions. These presentations are vital to the selection process, as it is this step that allows the Project Steering Committee executives to rapidly understand what the solutions will bring to the business. The strongest presentations are those that are based upon a prototype solution as it gives the clearest picture of the solution.

4. **The agency Executive Sponsor approves the final solution.** The Executive Sponsor uses the "best value" evaluation and the presentation information to determine which solution will best benefit the agency.

5. **The agency debriefs the participating business partners.** Once the Executive Sponsor has chosen a solution, a letter of intent to enter contract negotiations is sent to participating business partners. The business partners also receive a debriefing. At this time the Executive Sponsor and the Project Managers meet with each business partner to share the rationale for selection of the final proposal, and to share evaluation criteria of all prepared solutions. The only limitations in these debriefings are to ensure that confidential information, and protected properties (i.e., business partner's work product), are not revealed.

8. Contract Negotiations

The Contract Negotiations are entered into only with the business partner who had the winning solution. The contract negotiations may be the most challenging aspect of the Performance Based Procurement Model. The agency and business partner staff can not and should not rely on "standard contracts", whether standard State or standard vendor contracts. The agency and business partner staff must negotiate *new terms and conditions*. The new terms and conditions involve at least four significant changes:

1. **Deliverables and payments.** The "standard" contract accepts deliverables (goods and services) prior to implementation into production, and provides payment at milestone phases. The new contract is based upon the deliverable being in production and providing benefits, and the payments will be provided only if and when the benefits are realized!

2. **Project Management.** Many project management responsibilities have been included in contracts in the past in order to establish accountability at individual milestones. Accountability is now measurable by the success of the solution. Project management is an activity that must be done outside of the contract in order to have the flexibility needed to successfully respond to normal project variations.

3. **Costs and Solutions.** The business partners are expected to establish credible project costs (including profits) for the delivery of a solution which will provide sufficient benefits to pay the costs. If additional necessary costs are identified during project development and implementation, the additional costs are the responsibility of the business partner.

4. **Net Value.** The "net value" of the proposal and solution was estimated during the final solution evaluation. These contract negotiations can impact the real net value of the solution, requiring re-evaluation of costs and benefits.

Specifically, the terms and conditions that must be considered during contract negotiations include:

1. **Flexibility and Accountability**

The contract and solution should provide sufficient flexibility and accountability to accommodate the normally expected variations in the project. The contract should be based upon the delivered solution and its impact on benefits.

2. **Payment**

Payment should be based upon actual achievement of benefit streams. In other words, the system must perform, provide benefits, and those benefits then are used for compensation. The contract must also contain a payment cap, and a fixed termination date.

3. **Benefits**

A portion of the benefit stream is the source of funding for payments to the Vendor. The contract sets the terms and conditions for availability of benefits as payments as well as the payment cap.

a. The benefit stream is to be shared between the business partner and the agency.

b. The total cost including interest, payment schedule, and the percentage of benefits to be applied to payments are subject to contractual agreement.

c. If there are no benefits, then there will be no payment.

d. If the benefit streams exceed projections, the agency should have the option to make payments in accordance with the payment schedule or to make prepayment on the unpaid principal balance, with no prepayment penalties. Increased benefits do not increase payments to vendors, but do give the opportunity to accelerate payoff and thereby reduce interest costs.

e. If the benefits are less than expected, payment should be made at the contracted percentage of the realized benefits until the remaining balance is paid in full or the termination date of the contract, whichever is earlier. This may result in total payment to the Vendor being less than the payment cap.

4. **Costs**

a. The total cost of the contract is to include reasonable reimbursement for business partner costs, including interest on investment, and reasonable profit consistent with the risk of investment.

b. Cost changes should be limited or eliminated. The solution to be delivered should be sufficiently defined to preclude the need for repetitive changes to the solution and therefore repetitive amendments to the contract. This requires that the business partner be involved in managing the project to ensure adequate change control.

5. **Termination - Default**

The contract should include termination and default clauses - allowing the business partner and/or the agency to terminate the contract and control potential losses.

Business managers who have responsibility and accountability for the business goals and budget should lead the contract negotiations. The negotiating team should be supported by Legal Counsel and technical staff. Additionally, contract negotiations and changes may be necessary during the life of the project if externally mandated program changes occur that impact the scope, cost, or benefits of the solution.

9. Contract Award

At this time, the project solution, project plan, and funding plan have been finalized. However prior to award of the negotiated contract, several additional steps must be taken. These are the same steps that occur in any normal procurement activity, and require department and/or Control Agency review and approval:

1. **Project plan approval.** The project plan (a.k.a. Feasibility Study Report) must be approved to ensure that it is consistent with governing laws and guidelines.

2. **Funding plan approval.** The funding plan must be approved to ensure that authority for future payment is obtained.

3. **Review and approval of the proposed contract.** The terms and conditions of the proposed contract must be reviewed and approved to ensure consistency within governing laws and guidelines, and to ensure that adequate protection for the State is included.

With the approvals all in place, sign the contract and begin the project!

10. Project Development

Project development is certainly not going to be affected by the use of a Performance Based Procurement Model. Each project will contain the same problems and difficulties that are always present. There will, however, be some differences in the development of solutions to the problems, in the overall project management activities, and in the working relationships during project development.

- Problem resolution will be affected by having increased shared interest in rapid problem identification and resolution. Business partners and agency staff will have to adopt effective change control procedures to ensure that the project is completed on schedule, and still provides the benefits expected. It is unlikely that “nice to have” changes will be included if the changes increase the project cost or delay the development.

- Project management will certainly be affected because of the dynamics of having the business partner involved in project management decisions. The addition of complexity in Project Management will hopefully be offset by the improvement in joint decision making.

- Working relationships between agency staff and business partner staff will be affected because they will now share a mutual interest in delivery of a workable solution. In addition, it is likely that some agency program staff will be unhappy with the need to delay some “nice to have” changes in favor of bringing the solution to production on schedule.

There will be other changes as the basis and the dynamics of business solution development is altered.

It is recommended that the agency hold a formal project kickoff to allow agency staff to meet business partner staff and to learn first hand the roles that the various players will have.

FOR MORE INFORMATION

The Franchise Tax Board will provide more detailed information for anyone interested in exploring the Performance Based Procurement Model further. This information includes:

1. Samples of actual documents used by the Franchise Tax Board.

2. Executive level white paper.

To obtain this information please send your request to:

Ralph Shoemaker, Assistant Executive Officer
Franchise Tax Board
P. O. Box 2229
Sacramento, California 95812-2229

ATTACHMENTS

Attachment I

Performance Based Procurement Checklist

Step #	***Action***	***Outcome***
____ 1	Define problem and Business Case	Problem/Definition
		Recommendation
____ 2	Obtain approval to solve problem	Approval to proceed
____ 3	Establish teams	Project organization
____ 4	Conceptual Business Proposal	Problem and approach described
____ 4a	Establish proposal evaluation criteria	Rules governing competition
____ 5	Establish quality Business Partnerships	Pool of potential partners
____ 5a	Establish and use selection criteria	Pool of partners
____ 6	Conceptual Business Solution	Solicitation for Proposal
____ 6a	Work with Partners to solve problem	Partners understand problem/
		Agency understands solution
____ 6b	Partners write and submit draft proposal	Draft solution
____ 6c	Work with Partners to refine draft proposal	Best solutions
____ 6d	Partners write and submit final proposal	Final solutions
____ 7	Evaluate final proposals for “best value”	“Best value” evaluations
____ 7a	Document evaluation of final proposals	Selection rationale
____ 7b	Select final proposal	Selected proposal
____ 7c	Announce Selection	Partners notified of results
____ 7d	Debrief Partners on selection rationale	Partners understand basis of selection
____ 8	Negotiate contract terms and conditions	Performance Based Contract
____ 8a	Obtain approvals	Approved plan, funding & contract
____ 9	Award contract	Signed contract
____10	Develop project	Project deliverables

Attachment II

Quality Partnering Agreement

This agreement documents that __________________________ and the Franchise Tax Board have committed to a partnering process based upon mutual trust, honest and open communication and teamwork. The primary objective of this process is to establish a long-term working relationship which serves our customers and promotes the economic and social goals of the State of California.

Partners agree to:
Develop a mutually beneficial long-term business relationship, which produces measurable results in an environment of integrity, ethics and trust.

Support the mutual strategic goals while planning and implementing continuous improvement in products, services, processes and employee involvement.

Actively pursue projects that focus on automated solutions which provide revenue to the State while developing and improving products for market on a shared risk/reward basis.

Promote a cooperative relationship in which conflicts are resolved through negotiation instead of legal remedies.

Openly communicate requirements, make special efforts to understand them, consider the capabilities of the other partner, and agree to strive to meet requirements 100% of the time.

Be accountable for their commitments and follow through by supporting the verbal and written commitments they make.

Anticipate and meet mutual internal/external customer’s needs for this project.

Commit themselves to a program of continuous improvement.

Recognize and reward the contributions of each partner.

Promote the marketing of products produced by the partnership while protecting the intellectual property of each partner.

Dedicate themselves to the continued improvement and growth of the California State economy including achievement of goals for participation of minority, women and disabled veteran businesses in all contract agreements for this project.